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3 November 2022

2022-23 Rate peg methodology review
Independent Pricing and Regulatory Tribunal
PO Box K34
Haymarket Post Shop NSW 1240

Dear IPART,

SUBJECT: Submission on review of the rate peg methodology – Issues Paper

<u>Response to questions presented in the IPART Issues Paper:</u>

1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?

- Generally the main cost components and weights in the LGCI appears to be consistent with Mid-Western Regional Councils expenditure. However we would like to highlight some areas of escalating costs including insurance, fuel and software/IT. We recommend that this LGCI basket of goods be revised more regularly, say every two years.
- The two-year lag between the price change and the period in which this can be recovered in the rate peg is much too long. Whilst we acknowledge the lag is only temporary, it is not acceptable for Council to be expected to carry the financial burden of this lag as services to the community will suffer. For example a temporary pause or reduction in asset maintenance can cause a lasting impact if assets deteriorate to a poor condition, resulting in higher costs in the future to bring back to a satisfactory standard. We recommend that where using Consumer Price Index and Producer Price index that the most recent quarter end data as published by the Australian Bureau of Statistics is used.
- In addition to account for unavoidable lag we recommend that there is an element of forecast inflation factored into the LGCI. During periods of volatility this would allow some for the rate peg to be somewhat forward looking for Council's financial planning. The forecast would then the following year be corrected by comparing to the actual so that ratepayers were protected against forecast errors.
- Finally the inflator used for Employee benefits and on-cost should incorporating an element of the Local Government (State) Award increase.

2. **What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?**

We recommend that the annual Financial Data Return could be reviewed to provide better cost information to inform IPART of actual changes in costs.

3. **What alternate data sources could be used to measure the changes in council costs?**

In relation to forecast changes in costs each Council is required to use available data and professional judgement to forecast financial plans as part of the Integrated Planning and Reporting process. Various sources of information can be found from agencies such as the Reserve Bank of Australian, NSW Treasury Corporation or corporate economists. It is recommended these sources could be investigated for use in forecasting changes in costs to be incorporated in the rate peg calculation.

4. **Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?**

It seems evident from the two years of population factor increases to the rate peg that the result for the vast majority of Councils falls well short of the potential benefits forecast by IPART in the 2016 Review of the Local Government Rating System. IPARTS final report recommendation relied on increases to Councils rates base as capital improved values increased due to development. As the NSW Government did not support the change to CIV, the recommendation was always going to be difficult to fulfil under the current UV system.

The IPART final report correctly stated "Under the current UV methodology, the current 'growth outside the rate peg process results in an increase in general income from new development that is typically much lower than the increase in costs of servicing new residents and businesses." (Page 46).

We submit that the methodology adopted to increase rate income for population increase does not, in most cases, reflect the increased cost to Councils' as population increases for the following reasons:

- The methodology assumes the average rate per capita is reflective of the increased cost per capita of servicing new developments/population. This is not correct in most cases, as areas of new development require increased infrastructure and service costs over and above those required in existing developments.
- The process assumes supplementary valuations and population increase happen in the same year. This usually is not the case. It is therefore a matter of luck, as to if supplementary growth in a year is less than or greater than population increases due to developments which will likely have occurred in previous years.
- As with the LG cost index, the statistics used are rearward facing, rather than relying on forecasts which would enable the rate cap increases to be accrued at the same time the increased costs are being incurred.

We recommend that IPART carry out a review of the population factor increases that have accrued from the first years of the scheme, and compare that result to estimates that might have accrued under the model originally put forward. This would provide an informative test as to the success or otherwise of the current methodology. We expect such an assessment may show the current system is inadequate.

As such, the NSW Government should urgently reconsider its position relating to the implementation of CIV as the basis for calculating Council rates

5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?

We agree with the NSW Revenue Professionals response that:

- Each council has different service levels and community needs, improvements in productivity are part of our IP&R process. Any productivity gains should be encouraged and allowed as they will surely encourage future productivity gains that will benefit their communities. Penalising councils for efficiency gains is a disincentive for innovation and should be removed.

6. What other external factors should the rate peg methodology make adjustments for? How should this be done?

We agree with the methodology used to adjust for new costs identified, and if they are temporary that they be removed the following year. We think that consideration should be given to adjusting for other external costs outside of Council's control such as:

- Recognition of State Government Cost shifting. New initiatives and regulations forced upon Local Government often have a cost impact that is not adjusted for in the rate peg. A recent example of this is the implementation of the e-planning portal. Due to the poor user experience and lack of easy integration with Council's software we have needed to increase labour costs to transfer information manually from our software to the e-planning portal and back multiple times. We now face the cost of engaging IT specialists to write an integration solution and ongoing licencing costs. The government only provided partial and one-off grant funding to account for this.
- Natural disaster recovery. Whist we acknowledge that funding is available to restore essential public assets, this workload will impact and delay Council's usual planned asset management. Some allowance could be made to support the community, improve resilience or catch-up on delayed works.

7. Has the rate peg protected ratepayers from unnecessary rate increases?

Rate pegging has theoretically only allowed Council rates to keep pace with costs, with forced productivity and does not consider what is necessary or desired by the community. Where Councils have requested permission for additional rating revenue through the special rate variation (SRV) process there is an extensive consultation process so it would be difficult to argue that these rate rises were unnecessary.

8. Has the rate peg provided councils with sufficient income to deliver services to their communities?

We do not believe that the rate peg has provide sufficient income. We make the following points in relation to this statement:

- As mentioned above the rate peg is designed so that it only allows councils to keep pace with costs. It does not consider that service requirements or preferences may change or increase which have an impact on costs. We note that undertaking an SRV application is a costly exercise.
- Previous productivity factors were applied therefore reducing Councils ability to deliver the existing services
- Cost shifting has not been considered in the rate peg methodology
- Population increase has only just been introduced. Our LGA has continually experienced growth yet has not until now had the ability to receive additional funds to cater for this
- We note from the issues paper that 182 special variations applications have been received since 2011-12. This highlights that the base rate peg is not sufficient.

9. How has the rate peg impacted the financial performance and sustainability of councils?

Certainly, the rate peg has limited Councils ability to raise rates when needed to meet increasing costs. Council has not been able to reduce the infrastructure backlog and is still very reliant on grant funding.

10. In what ways could the rate peg methodology better reflect how councils differ from each other?

We do not have access to the data to determine how councils' costs differ across the state.

11. What are the benefits of introducing different cost indexes for different council types?

If the different cost index more closely matched the cost increases experienced by Council's then this would be an improvement to the current goal of the rate peg. We would view having a different cost index with caution as it could have unintended negative consequences.

12. Is volatility in the rate peg a problem? How could it be stabilised?

Volatility in the rate peg should not be a problem if there was not an approximately 2-year lag in the LGCI. When inflation stabilises, the problem will be explaining to the rate payers for up to 2 years why their rates are still sharply increasing.

13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

Our preference is that the rate peg compensates councils for changes in the costs of providing local government goods and services in a timely manner.

14. Are there benefits in setting a longer term rate peg, say over multiple years?

The benefit would give ratepayers some more certainty on future rates, but also would be subject to the timing of land valuation changes. As a negative it may introduce further lag between the rate peg LGCI and variance to actual costs.

15. Should the rate peg be released later in the year if this reduced the lag?

No, we do not agree. The current release dates allow Council prepare the Operational Plan with certainty over what the rating income will be.

16. How should we account for the change in efficient labour costs?

We believe accounting for actual labour costs should be aligned with changes in the NSW Local Government (State) Award to be more reflective of council's costs. The cost of attracting quality staff should also be factored in, these costs may be identified through sector-based advertising agencies.

Superannuation guarantee increases also need to continue to be factored in.

We support the sector and do not believe that productivity factors can be accurately measured in a sector as diverse as local government.

17. Should external costs be reflected in the rate peg methodology and if so, how?

Yes. External costs that apply to all councils uniformly should be included in the rate peg methodology. Before compelling Council's to undertake new services or introduce new regulations State and Federal Governments should seek to understand the cost impact on Local Government. This could mean applies a uniform adjustment to all Council's or differing council adjustments. For example, some areas where external costs have been forced upon Council without adequate funding are:

- NSW Planning Portal
- Audit Risk and Improvement Committee
- Joint Organisations
- Development compliance
- State Significant Developments approved
- Emergency Service Levy
- Increase Flood plain management planning
- NSW Audit Office Fees
- Councillor superannuation

18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?

Yes, Council specific adjustments for external costs are needed as outlined above. In addition, should the community and Council wish to expand, vary or introduce new services as agreed in consultation with the community, there should be a simpler way than the current SRV process for achieving this through rating revenue.

We would recommend investigating a simpler application process for Councils applying to IPART wishing to increase rating revenue by smaller amounts. Rather than Council's delaying necessary minor rate increases to avoid the SRV process, a simpler process may actually allow Councils the option to provide moderate increases over many years rather than deferring change until there is an urgent need and results in a sharp SRV increase.

19. What types of costs which are outside councils' control should be included in the rate peg methodology?

These types of costs are mentioned above at question 17.

20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

We do not believe we are impacted by the complexity of the calculation. It is noted that 14 of the 26 components of the LGCI have a weighting of less than 1%. Therefore, it likely there would be no material impact and would likely improve understanding of the calculation by removing these items or combining into other costs and using an All Groups CPI.

Thank you for the opportunity to comment on the draft report, if you have any questions in regards to our submission please do not hesitate to contact Council.

Yours sincerely

Neil Bungate Digitally signed by Neil Bungate Date: 2022.11.03 10:40:52 +11'00'

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